THE PIMSLETTER

on Business Strategy

Number 6

Unions and Profits

SPI THE STRATEGIC PLANNING INSTITUTE

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UNIONS AND PROFITS

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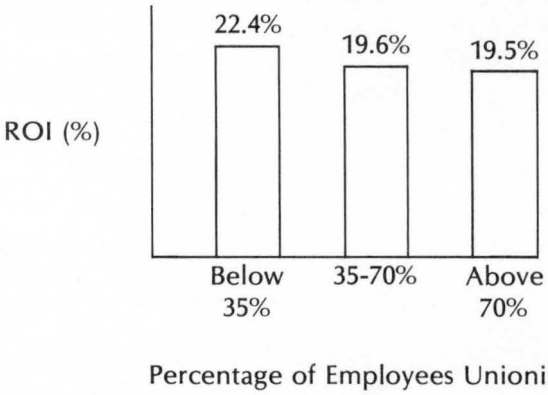
Few businessmen will be surprised to hear that labor unions reduce profits. But it is not at all obvious *how* this happens, and *where,* and what the appropriate *remedies* might be.

The Basic Facts

Exhibit 1 shows the simple relationship between unionization and ROI.

EXHIBIT 1:



Here, as in all other exhibits in this brochure, we are looking at the businesses in the PIMS data base, suitably arranged. Perhaps the only surprise in this exhibit is the moderate extent of the damage to profitability.

Two clues to *that* are given in Exhibits 2 and 3.

EXHIBIT 2:

Relative Market Share	ROI (%)	Percentage of Employees Unionized: Low (35%)	Medium (70%)	High
	Low (26%)	13	13	13
	Medium (63%)	20	17	18
	High	34	29	27

It is primarily the high-market-share businesses that are impacted by unionization, as we see by looking across the bottom row. Unions seem to go where the money is, or at least make their major effort there. These are the businesses which have the operating economies, market clout, and visibility. Union negotiators apparently concentrate their efforts on such businesses to establish industry bargaining patterns.

EXHIBIT 3:

Long-run Market Growth Rate	ROI (%)	Percentage of Employees Unionized: Low (35%)	Medium (70%)	High
	Low (6%)	24	18	17
	Medium (9%)	25	19	19
	High	20	22	24

Further, unions have the greatest impact in mature, slow-growth industries, as shown in the top two rows of Exhibit 3.

Not only are unions more firmly established in mature industries, but the intensity of concern of employees over job-security issues may be heightened by the relative lack of opportunities.

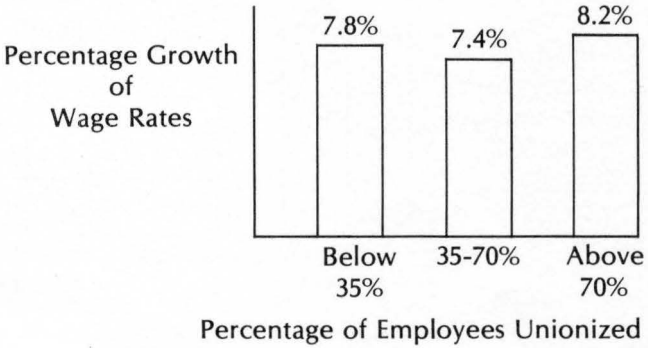
The overall pattern of Exhibit 1 therefore *understates* the profit effect of unions in the areas where they concentrate their attention. The profit effect is negative and pronounced.

Caution: The PIMS data base is heavily weighted toward *Fortune*-500 manufacturing businesses. Therefore, this discussion of unionization may not apply to highly fragmented industries, such as women's dresses or farming or trucking or barber shops.

How Do Unions Reduce ROI?

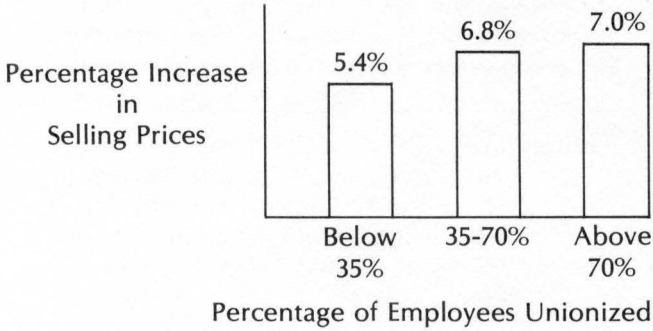
The ROI reduction does *not* happen because unions extract greater wage-rate increases (inclusive of benefits) from the employing business, as seen in Exhibit 4.

EXHIBIT 4:



Even in the column on the right, the effect is too small to account for the profit drop. If we look also at what happens to selling prices, a bit of mystery arises.

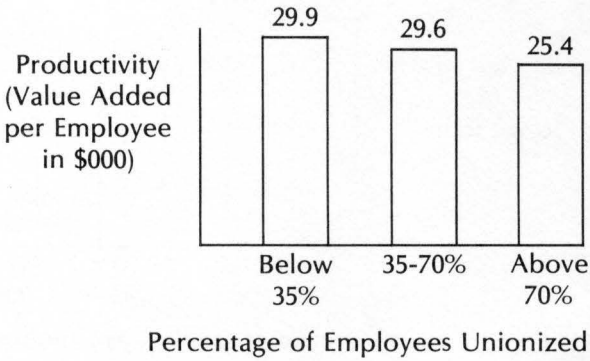
EXHIBIT 5:



One would expect the low-union businesses to be least profitable, given that they raise their wage rates almost as fast as the high-union businesses but increase their selling prices far less.

The mystery is cleared up in Exhibit 6.

EXHIBIT 6:



The low-union businesses are able to protect their earnings by being productive. The high-union businesses suffer in their profitability by being relatively less productive.

What to DO?

Among the reasons that could account for the low productivity of high-union businesses are (a) restrictive work rules and other restraints on output imposed by unions, or (b) a lesser willingness or ability of employers to invest in mechanization or automation. Suppose, for the sake of argument, that employers are powerless to affect work rules; can they overcome the problem by heavier investment? While a heavier investment per employee certainly improves output per employee (see a forthcoming PIMSLETTER on Productivity), the ROI impact is not consistently positive. In fact, increased investment usually has a *negative* ROI impact, as we can see by looking down the various columns of Exhibit 7.

EXHIBIT 7:

Investment Per Employee ($000)	Percentage of Employees Unionized: Low (35%)	Medium (70%)	High
Low (17)	27	21	22
Medium (27)	20	19	18
High	20	19	18

ROI (%)

Part of the reason for this profit decline undoubtedly lies in the generally profit-damaging effect of investment intensity, as reported in PIMSLETTER 2.

Two answers seem to remain for the business beset by a productivity-reducing union situation:

(1) To *bargain harder* on matters relating to productivity;

(2) To *invest selectively* in those areas where, even with a reduced *percentage* ROI, the *dollar* earnings will go up, because the (hopefully) moderately lower percentage is earned on a larger investment base.

The Strategic Planning Institute (SPI) is a non-profit tax-exempt membership organization, dedicated to the advancement of strategic business management. Its expanding member-group of large and small corporations contains companies from many diverse industries and from several foreign countries. The PIMS Program is the major program of SPI.

The PIMS data bank currently contains the strategy experiences, good and bad, of over 1200 product and service businesses operated by the 180 present members of SPI. Each experience is documented in terms of: actions taken by the business; the nature of its served market; the kind of competitive environment; and the financial results. In all, over 200 separate characteristics of each business experience are available for study.

PIMS research is incorporated in a series of computer models which diagnose the strategic position and prospects of an individual business. The findings discussed in each PIMSLETTER represent *only a part* of the research results used in PIMS models. While the findings reported in this PIMSLETTER may offer insights on a specific area of strategic significance to a business, they cannot be used to evaluate a business as a whole. The overall evaluation can be performed only by the models.

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